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SUBJECT: ECONOMIC SCENESETTER FOR CODEL PELOSI

¶1. (SBU) The U.S. Mission in Pakistan warmly welcomes your January 27-28 visit to Islamabad. Your visit coincides with a period of expanding and deepening engagement between the U.S. and Pakistan on a range of key economic and trade issues. Reforms pioneered in 1999 by Prime Minister Shaukat Aziz in his earlier role as Finance Minister, and strongly supported by President Musharraf, have been very successful in taking Pakistan from the brink of collapse, through a smooth recovery, and on to steadily improved economic growth. In 2005, Pakistan's 8.4 percent GDP growth was second best in Asia, although in the fiscal year ending June 2006, growth slowed slightly to 6.6 percent, due in large part to higher energy prices. For FY 2007, growth is expected in the 6.5 to 7 percent range, fairly balanced across all sectors, although services, especially telecommunications and banking, are particularly strong. Inflation spiked beyond ten percent last year, but the State Bank of Pakistan has taken steps to address the issue and it is now in the seven percent range. Concerns remain, however, about the lack of diversity in Pakistan's exports, which continue to be dominated by textiles and apparel, and a growing current account deficit.

¶2. (SBU) The U.S. is the largest export market for Pakistani products; in 2005, Pakistan exported USD 3.3 billion of goods to the U.S., while the U.S. exported USD 1.2 billion to Pakistan. The U.S., cumulatively, is the largest foreign investor in Pakistan. There are over 80 U.S. companies operating in Pakistan, primarily in the pharmaceutical, IT, oil and gas, financial services and restaurant sectors.

¶3. (SBU) The GOP's top leadership has installed a team of trusted technocrats and ministers who have carried out a comprehensive overhaul of Pakistan's economic policies. This effort initially focused on core problems such as reining in government deficit spending, privatizing the financial sector, and increasing education and development spending. The GOP has built on these successes and is now focusing on additional banking, tax, capital market, and judicial reforms, as creating an environment conducive to doing business. The GOP has implemented an aggressive privatization program, which includes selling shares in a number of state-owned companies (e.g., Pakistan Telecom and Karachi Electric Supply Corporation). Proceeds from these privatizations have generated large inflows of capital.

¶4. (SBU) We launched a U.S.-Pakistan Dialogue in March 2006, which Under Secretary of State for Economic and Business Affairs Sheeran inaugurated. In addition to offering support with domestic reforms - such improved Intellectual Property Rights protection - and regional economic integration, the Dialogue has a sectoral focus on education, science and technology, and energy.

¶5. (SBU) Bilateral Investment Treaty (BIT): After coming close to an agreement on a BIT with Pakistan in the run-up to President Bush's March 2006 visit, progress was dormant until early September 2006, when, at the instigation of the Prime Minister's office, negotiating sessions re-started. Pakistan's Attorney General took the lead on the GOP side, but progress stalled after several weeks.

The GOP is now forcefully pushing linking an agreement on a BIT to a Free Trade Agreement with the U.S.

¶ 6. (SBU) Container Security: The GOP expressed strong interest in participating in the U.S. Container Security Initiative (CSI), and a CSI agreement was signed during President Bush's March 2006 visit. We expect that a CSI cargo container scanning facility at Port Qasim, near Karachi, will be up and running by February 2007. This facility will combine high-speed transmission of scanned images and checks of suspect containers by local USG Pakistani employees. CSI should improve U.S. national security and expedite clearance of Pakistani exports to the United States.

¶ 7. (SBU) Reconstruction Opportunity Zones (ROZs): High on the bilateral list is the mutual desire to craft an ROZ proposal that meets Pakistani and Afghan expectations to bring sustainable economic benefits to underdeveloped areas, including earthquake affected areas in Pakistan and Pak-Afghan border areas (particularly the Federally Administered Tribal Areas (FATA), North West Frontier Province, and Balochistan). The GOP believes that tariff benefits must be of sufficient duration to make relocating industrial production worthwhile, and textiles and apparel must be included. In August and September, 2006, a team of consultants funded by USAID spent several weeks in both countries researching possible products and locations. They submitted their report in October, and Washington stakeholders are currently drafting ROZ legislation to present to Congress within the next few months. While it will require a concerted effort, including infrastructure and marketing support, to ensure their success, ROZ's are a critical component in our overall counter terror and development strategy, and they have the strong support of the Government of Pakistan.

Crocker